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## Natural Business year - Its Advantages to Business Management

American Institute of Accountants

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THE NATURAL BUSINESS YEAR-  
ITS ADVANTAGES TO BUSINESS MANAGEMENT

(Received  
Feb 14, 1950)

The American Institute of Accountants  
270 Madison Avenue  
New York 16

## What Is the Natural Business Year?

The natural business or fiscal year of an enterprise is the period of twelve consecutive months ending when its activities have reached the lowest point in their annual cycle. At this time-

Inventories, depleted in the active selling season, have not yet been replenished.

Receivables are at their minimum, or declining, as customers remit in payment of the year's largest invoices.

Bank loans, which provide each year the cash resources required for current operation in a period of peak activity, have been liquidated, or reduced to their annual minimum.

Most enterprises, including corporations not organized for profit, have a natural business year. With the exception of public utilities, railroads and a few other industries subject to government regulation, any corporation is free to choose whatever "accounting year" is most convenient.

The natural business or fiscal year has no relation whatever to the "thirteen-month year", or to any movement for calendar reform.

The present period in business operation, with high taxes, wages, and costs, brings for all lines of business and industry problems placing a high premium upon efficiency. Time is of the essence.

Conditions impose upon executives the obligation to use every known device, including accounting, to save a dollar, save a day, save a man.

Executives guiding the operations of corporations are constantly confronted with questions like this:

"How can I speed up output?....reduce waste?.... maintain a reasonable margin of profit?...."

Adoption of the natural business year is one of the answers to these questions. This statement tells why.

#### Advantages of the Natural Business Year

The advantages lie in the facilitation of operations essential to the proper conduct of a business. For example, the preparation of FINANCIAL STATEMENTS--Financial statements prepared at the end of the natural business year more accurately reflect the facts of the business. Inventories and receivables are usually among the most important items in the balance-sheet. Their "valuation" involves a degree of estimate ("cost or market--what is market?", "bad debt reserve"). These items are smallest at the end of the natural business year; they have been largely converted into cash. The degree of estimate is correspondingly reduced.

Profit can be more accurately calculated at the natural year end, particularly in the case of the last-in, first-out method. Inventory has been sold, and the proceeds have not yet been reinvested in new inventory. At a later date, the complex problems of inventory valuation must be solved to calculate profit.

TAX LIABILITY--A company's tax bill for any fiscal year depends primarily upon the amount of its income. Tax liability can be computed most accurately at the end of the natural business year, because profit determined at that time reflects more facts and fewer estimates.

INVENTORY TAKING--Taking inventory at the end of a natural business year has many advantages. Stocks are relatively small and inactive, and can be checked and tabulated more quickly.

There is a minimum of interference with productive activities, because normal operations have temporarily declined at the end of the natural business year. Regular employees, relieved to some extent of their normal responsibilities, are available to assist in inventory-taking.

In some organizations, part of the work of taking inventory is distributed throughout the year. Nevertheless, there remains the last-minute task of bringing the records up to date and summarizing them, preparatory to closing the books at the end of the annual natural fiscal period.

PLANNING AND CONTROL--New policies are usually introduced at the beginning of the natural business year. Financial statements prepared at the end of such a period, because they reflect the results of these policies over one complete cycle of operations, provide management with a check on their effectiveness. Statements prepared at any other date combine the results of parts of two distinct periods, and make comparisons between them difficult, if not impossible.

UNIFORMITY IN THE SAME INDUSTRIES--Most types of businesses have grouped themselves into associations or similar organizations, these formed for the purpose of mutually serving the members in various ways. Among the services given is distribution of technical information, departmental costs, percentages of turnovers and other useful data. This material is furnished by, among other sources, trade journals, and statistical services which specialize in supplying facts and figures for particular industries.

In order to have information which permits required analyses and comparisons, it is important for member firms to submit figures based upon the same fiscal year (or full cycle) as the others in their group. Here again the natural business year has come into its own as a necessary tool of business.

BANK CREDIT--If the business executive takes advantage of the opportunity presented at the end of the natural business

year to review his past operations and plan for the future, he can most easily estimate the bank credit which will be required during the succeeding twelve months.

Before a banker passes on an application for credit, he requires a statement of financial condition. He usually prefers a statement prepared at the end of the natural fiscal year--supplemented, perhaps, by a brief memorandum concerning peak debt loads and maximum inventories--because it reflects more facts and less estimate. It is to the advantage of the applicant, also, if the financial statements submitted show the concern in its most liquid condition, which is true only at the end of a natural fiscal year.

#### How to Determine the Natural Business Year

Because the natural business year of an enterprise closes at the end of the month in which its activities are at or near their annual minimum, an important preliminary step in adopting the natural business year is to determine this month. (A chart which facilitates this operation accompanies this statement).

#### How to Adopt the Natural Business Year

Operations involved in adopting the natural business year are few and simple. In establishing a new corporation, the desired fiscal year is simply written in the by-laws. For existing corporations whose fiscal year has

been the calendar year, one of the first and most important requirements is to request from the Commissioner of Internal Revenue at Washington--using Form 1128--permission to effect the desired change. This form is to be filed 60 days prior to the date selected as the close of the natural business year. Requests for such permission, when based upon sound reasons, are generally approved without further inquiry. Similar permission must be secured from state authorities in states which require corporations to file income-tax returns. It is usually granted upon notification that Federal authorities have approved the change.

A separate Federal tax return must be filed for the interim period between the end of the calendar year and the beginning of the new natural fiscal year. This interim return is identical in form with the annual return. A corresponding state income-tax return, for the interim period, must be filed in states which require annual returns of corporations.

It is also necessary, if the company is subject to the jurisdiction of the Securities and Exchange Commission, to prepare an interim report for that body when the period between the end of the calendar year and the beginning of the natural fiscal year is three months or longer.

#### Taxes and the Natural Business Year

A change to the natural business year may or may not have temporary tax advantages, depending upon changing



State and Federal laws. This matter can be determined in consultation with accountants and attorneys prior to the contemplated change of dates.

What Executives Say About  
the Natural Business Year

The vice president and treasurer of a steel mill writes: "It is, of course, logical to close the books at a time when inventories are at a minimum for a greater efficiency in taking inventory, because it interferes least with manufacturing operations as well as reducing the actual count in taking it. It is also at a time when our current borrowings are at a minimum or nearly eliminated."

The secretary and treasurer of a cannery writes: "Adopting the fiscal year...gives us a better picture of our yearly operations...On the fiscal year basis we have the entire operations in the one year and therefore results obtained thereby are considerably more satisfactory to us."

The vice president and treasurer of a coal company writes: "In the first place, our industry is seasonal and by using the fiscal year ending April 30th we are always sure to include the whole of the burning season within the fiscal year. In the second place, our labor contract with the miners expires on March 31st.... In the third place, contracts for the sale of coal are usually consummated in the spring after the wage scales have been adjusted."

# NATURAL BUSINESS YEAR DETERMINATION CHART

19	Inventories at Close of Month															
	Production		Raw Materials		Goods in Process		Finished Goods		Sales		Accounts Receivable		Accounts Payable		Notes Payable	
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
Jan.																
Feb.																
March																
April																
May																
June																
July																
Aug.																
Sept.																
Oct.																
Nov.																
Dec.																
		100%		100%		100%		100%		100%		100%		100%		100%

## Form for Use With Determination Chart

Nature of business..... How long in business..... Present fiscal year.....  
 Location of plants..... Location of principal sources of supply.....  
 Stocks listed on..... Bonds listed on..... Exchange  
 Does company use perpetual inventory system?..... How often is physical inventory taken?.....  
 Statements prepared by company monthly..... Cumulative..... 12 months ended.....  
 Use made of statements prepared by company.....  
 Use made of reports of auditors.....  
 Does company use a budget?..... What is fiscal year for budget?.....  
 Reports to stockholders: Annually..... Semi-annually..... Quarterly.....  
 If partnership, do partners report income to U. S. Government for same period as partnership?.....

## Comments and Suggestions

The above forms are intended for use in obtaining information with for all of the columns and spaces in the chart. In others, fluctuations will regard to seasonal fluctuations in specific businesses or industries, for the be more clearly indicated by additional or substitute headings.  
 purpose of determining whether changes in fiscal years might be of Information for more than one year obviously would furnish a more dependable guide to seasonal fluctuations than information for only one year. Where practicable, it should be obtained for a period of years.

*Additional copies of the above natural business year determination chart may be secured without charge from the American Institute of Accountants, 13 East Forty-first Street, New York, N. Y.*